CLERK'S COPY.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 48

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

JOHN STUART

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 19, 1942
CERTIORARI GRANTED APRIL 27, 1942

In the
United States Circuit Court of Appeals
For the Seventh Circuit

No. 7695

JOHN STUART,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Review of Decision of the United States Board of Tax Appeals.

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1 John Stuart, *Petitioner*, vs. Commissioner of Internal Revenue, *Respondent*. } Docket No. 97500.

Appearances:

For Taxpayer: Herbert Pope, Esq., Benj. M. Price, Esq., Preston B. Kavanagh, Esq.

For Comm'r: D. A. Taylor, Esq.

DOCKET ENTRIES.

1939

Mar. 14—Petition received and filed. Taxpayer notified. (Fee paid.)

Mar. 14—Copy of petition served on General Counsel.

Mar. 14—Request for circuit hearing in Chicago, Ill., filed by taxpayer. 3/14/39 copy served.

May 2—Answer filed by General Counsel.

May 8—Copy of answer served on taxpayer. Chicago, Illinois, Calendar.

1940

Mar. 22—Hearing set May 6, 1940, Chicago, Ill.

May 6—Hearing had before Miss Harron, Div. 13, on merits. Submitted. Amended answer filed. Stipulation of facts and amendment to answer filed May 8, 1941. Both briefs due 6/20/40; Reply briefs 2/5/40.

May 16—Transcript of hearing of May 6, 1940 filed.

May 19—Brief filed by taxpayer. 6/21/40 copy served on General Counsel.

June 20—Brief filed by General Counsel.

July 5—Reply brief filed by taxpayer.

Nov. 30—Memorandum findings of fact and opinion rendered, Marion J. Harron, Div. 13. Decision will be entered under Rule 50.

Dec. 16—Computation of deficiency filed by General Counsel.

Dec. 18—Hearing set Jan. 15, 1940, on settlement.

1941

Jan. 9—Consent to settlement filed by taxpayer.

Jan. 10—Decision entered, Harron, Div. 13.

Apr. 1—Supersedeas bond in the amount of $49,286.00 approved and ordered filed.

Apr. 3—Petition for review and statement of points by United States Circuit Court of Appeals, Seventh Circuit, filed by taxpayer.

Apr. 5—Proof of service of filing petition for review and statement of points filed.

May 6—Motion for 30 days extension within which to settle the evidence and transmit the record filed by taxpayer.

May 6—Order enlarging time to June 12, 1941 to prepare and transmit the record, entered.

2 May 29—Agreed statement of evidence filed.

May 29—Agreed praecipe for record filed.

Filed Mar. 14, 1939.

3 UNITED STATES BOARD OF TAX APPEALS.

John Stuart,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.
} Docket No. 97500.

PETITION.

Filed March 14, 1939.

The above named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:R:D:1:AHS-90D) dated December 29, 1938, and as a basis of his proceeding alleges as follows:

1. The petitioner is a resident of Hubbard Woods, Illinois, and his residence address is 990 Sheridan Road, Hubbard Woods, Illinois. He filed his income tax returns for the years here involved with the Collector of Internal Revenue for the First District of Illinois.

2. The notice of deficiency, a copy of which is attached hereto and marked "Exhibit A", was mailed to the petitioner on December 29, 1938.

3. The taxes in controversy are income taxes for the years 1934 and 1935. The deficiencies claimed by the Commissioner are $14,054 for the year 1934 and $10,-
4 588.60 for the year 1935, of which approximately $12,000 for 1934 and $9,000 for 1935 are in dispute.

4. The determination of the deficiencies set forth in said notice is based upon the following error:

The determination by the Commissioner that the income of three trusts created by the petitioner for the benefit of his children was taxable to the petitioner under the provisions of Section 166 of the Revenue Act of 1934.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) On March 31, 1930, the petitioner, by three separate trust agreements, created three trusts for the benefit of his three children respectively. The trustees of each trust are the petitioner, his wife and his brother. Each trust agreement provides a life income for the child for whose benefit the trust was created and for a division of the principal on the death of the child among the issue of the child, with contingent gifts to other persons if there shall be no issue then living.

(b) There was and is no provision in said trusts under which the petitioner could ever receive any principal or income thereof. The petitioner did not retain the power to revest in himself title to any part of the principal of
5 the trusts.

(c) The petitioner wanted to have his children protected and, accordingly, provided in paragraph Ninth of each of the trust agreements that his wife and his brother, or the survivor, should have the right to amend the trust by changing the beneficiary, or by changing the time when income or principal should be payable, or in other respects, but there was no intention and no provision that they could modify the trust so as to revest in the petitioner title to any part of the principal of the trust. It was in fact specifically provided in paragraph Eighth of each trust that if the petitioner desired to exercise his right under the provisions of said paragraph to withdraw any property from the trust he could do so only upon first transferring to the trustees other property satisfactory to them, of a market value at least equal to that of the property so withdrawn. It was the intent of the trust agreements that no portion of principal could be revested in the petitioner by anyone without such substitution of other property satisfactory to the trustees and of at least equal value to the property withdrawn.

(d) The petitioner's wife and brother, who had power to modify the trust in the manner above stated, were also trustees and could not legally as trustees have revested any principal of the trusts in the petitioner except in
6 exchange for property of equal value which was satis-

factory to them. To remove any possible doubt as to this, and after a question had been raised as to the effect of provisions contained in Section 166 of the Revenue Act of 1934 which had not been contained in the corresponding section of the Revenue Act of 1928 in force when said trusts were created, the trust agreements were amended on August 3, 1935, by striking out said provisions of paragraphs Eighth and Ninth hereinabove described.

(e) In the audit of the petitioner's income tax returns for the years here in question the Commissioner included in petitioner's gross income the entire net income of said trusts for the year 1934 and for the period from January 1, 1935, to August 3, 1935, on the ground that such income was taxable to the petitioner under Section 166 of the Revenue Act of 1934, because of the alleged power in his wife and brother to revest the principal of the trusts in him.

(f) The petitioner avers that said trusts do not come within the provisions of Section 166 of the Revenue Act of 1934 and that the income of said trusts is not taxable to him under said statutory provisions.

Wherefore, your petitioner prays that the Board may hear this proceeding and redetermine the deficiencies
7 determined by the Commissioner.

Herbert Pope,
Benjamin M. Price,
Preston B. Kavanagh,
Counsel for Petitioner,
707 Munsey Building,
Washington, D. C.

8 State of Illinois, } ss.
County of Cook. }

John Stuart, being duly sworn, says that he is the petitioner above named; that he has read the foregoing petition and is familiar with the statements contained therein and that the facts stated therein are true.

John Stuart.

Subscribed and sworn to before me this 3rd day of March, 1939.

W. McKenzie Mothersill,
Notary Public.

(Notarial Seal)

9 EXHIBIT A.

December 29, 1938.

IT:R:D:1
AHS-90D

Mr. John Stuart,
990 Sheridan Road,
Hubbard Woods, Illinois.

Sir;

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1934 and 1935 discloses a deficiency of $24,642.60 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C. for the attention of IT:C1:P-7. The signing and filing of this form will expedite the closing your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

Guy T. Helvering,
Commissioner,
By (Signed) John R. Kirk,
Deputy Commissioner.

Enclosures:
Statement
Form of waiver AHS/AMEN-2

10 Statement.

IT:R:D:1
AHS-90D

Mr. John Stuart,
990 Sheridan Road,
Hubbard Woods, Illinois.

Tax Liability for Taxable Years Ended December 31, 1934 and 1935.

Income tax.

Year	Liability	Assessed	Deficiency
1934	$ 70,685.72	$ 56,631.72	$14,054.00
1935	83,295.81	72,707.21	10,588.60
Totals	$153,981.53	$129,338.93	$24,642.60

In making this determination of your income tax liability, careful consideration has been given to the revenue agent's report dated February 17, 1937; to your protest dated March 30, 1937, and to the statements made at a conference held in this office with your representative.

A copy of this communication has been transmitted to your representative, Mr. P. B. Kavanagh, 707 Munsey Building, Washington, D. C., in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

1934.

Adjustments to Net Income.

Net income as disclosed by return		$157,257.45
Unallowable deductions and additional income:		
(a) Taxes disallowed	$ 1,747.79	
(b) Interest paid disallowed	1,944.84	
(c) Fiduciary income increased	22,560.02	26,252.65
Net income adjusted		$183,510.10

11 Explanation of Adjustments.

(a) and (b) Your proportionate share of taxes and interest paid by a cooperative building corporation have been disallowed as proper deductions on your return in accordance with United States Board of Tax Appeals decision published in Volume 27, page 530.

(c) You failed to report income from the trusts created for the benefit of your three children, John Stuart, Jr., Ellen S. Poole, and Joan Stuart Scudder. An examination of the trust agreements covering these tree trusts indicates that in each case your wife, Ellen Shunway Stuart, and your brother, R. Douglas Stuart, as trustees, have full power to sell, transfer, or assign any or all of the stocks, bonds, or securities held by the trustees under the trust agreement and to invest and reinvest the proceeds thereof. Paragraph 9 of the trust instruments provides that during your life the said Ellen Shunway Stuart and the said R. Douglas Stuart shall have full power and authority by an instrument in writing signed and delivered by them or by the survivor of them to the trustees, to alter, change, or amend the trust agreement at any time by changing the beneficiaries, or by changing the time when the trust fund or the income thereof is to be distributed, or by changing the trustees, or in any other respect. This paragraph remained in effect until August 3, 1935; hence this office is of the opinion that for the year 1934 these trusts were revocable trusts and, therefore, are taxable to you under the provisions of section 166 of the Revenue Act of 1934. This section provides that;

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

• • • • •

"(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor."

The trustees under your trust agreements have full power over the disposition of the corpus and do not constitute an adverse interest.

12 Computation of Tax.

Net income adjusted		$183,510.10
Less:		
Personal exemption		2,500.00
Balance (surtax net income)		$181,010.10
Less:		
Dividends	$172,720.55	
Earned income credit	1,400.00	174,120.55
Net income subject to normal tax		$ 6,889.55
Normal tax at 4% on $6,889.55		275.58
Surtax on $177,010.10 (Amount in excess of $4,000.00)		70,435.35
Total tax		$ 70,710.93
Less:		
Income tax paid at source		25.21
Correct income tax liability		$ 70,685.72
Income tax assessed:		
Original, account #200277		56,631.72
Deficiency of income tax		$ 14,054.00

1935.

Adjustments to Net Income.

Net income as disclosed by return		$185,534.77
Unallowable deductions and additional income:		
(a) Taxes disallowed	$ 796.44	
(b) Interest paid disallowed	1,945.44	
(c) Interest	1,247.30	
(d) Taxes	122.42	
(e) Fiduciary income	16,800.00	20,911.60
Total		$206,446.37
13 Nontaxable income and additional deductions:		
(f) Interest on tax-free covenant bonds		1,247.30
Net income adjusted		$205,199.07

Explanation of Adjustments.

(a) and (b) See explanation (a) and (b) for 1934.

(c) and (f) Interest received on the securities listed below has been transferred from tax-free covenant bond interest to ordinary interest, inasmuch as these bonds do not carry the tax-free covenant clause:

Indian Hill Country Club	$150.00
Asheville School	300.00
Continental Securities Co.	400.00
Chicago Daily News	291.80
Riding Club	18.00
Pinehurst, Inc.	60.00
General Baking Company	27.50
Total	$1,247.30

(d) Under taxes you claimed your proportionate share of the taxess on a boat house at Charlevoix. This boat house appears to be club property; hence you cannot be allowed a deduction on your income tax return for taxes paid on property which does not belong to you.

(e) As fully explained on page 2 the income from the three trusts created for the benefit of your children during the period that these trusts are revocable, namely, January 1 to August 3, 1935, is taxable to you under the provisions of section 166 of the Revenue Act of 1934.

Computation of Tax.

Net Income adjusted		$205,199.07
Less:		
Personal exemption		2,500.00
Balance (surtax net income)		$202,699.07
Less:		
Dividends	$167,841.40	
Earned income credit	1,400.00	169,241.40
Net income subject to normal tax		$ 33,457.67
Normal tax at 4% on $33,457.67		1,338.31
Surtax on $198,699.07 (Amount in excess of $4,000.00)		81,957.50
Total tax		83,295.81
Less:		
Income tax assessed, original, account #204522		72,707.21
Deficiency of income tax		$ 10,588.60

AHS/AME N-2

Filed May 2, 1939.

UNITED STATES BOARD OF TAX APPEALS.

(Caption—97500)

ANSWER.

Filed May 2, 1939.

The Commissioner of Internal Revenue by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits, denies and alleges as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition herein.

3. Denies the allegations contained in paragraph 3 of the petition herein, except it is admitted that the taxes in controversy are income taxes for the years 1934 and 1935 and that the deficiencies claimed by the Commissioner are $14,054.00 for the year 1934, and $10,588.60 for the year 1935.

4. Denies that the respondent committed the error alleged in paragraph 4 of the petition herein.

5. (a) Denies the allegations contained in subparagraph (a) of paragraph 5 of the petition herein, except it is admitted that on March 31, 1930, the petitioner by certain trust agreements created three trusts for the benefit of his three children, respectively, and that the trustees of each trust are the petitioner, his wife and his brother.

(b), (c) and (d) Denies the material allegations of fact contained in subparagraphs (b), (c) and (d) of paragraph 5 of the petition herein.

(e) Denies the allegations contained in subparagraph (e) of paragraph 5 of the petition herein, except it is admitted that in the audit of the petitioner's income tax returns for the years here in question, the Commissioner included in petitioner's gross income the entire net income of said trusts for the year 1934 and for the period from January 1, 1935, to August 3, 1935, on the ground that such income was taxable to the petitioner under Section 166 of the Revenue Act of 1934.

(f) Denies the allegations contained in subparagraph (f) of paragraph 5 of the petition herein.

Denies generally and specifically each and every allega-

tion, contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz.: $24,642.60.

(Signed) J. P. Wenchel,
J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
F. R. Shearer,
Division Counsel.
D. A. Taylor,
Special Attorney, Bureau of Internal Revenue.

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17 UNITED STATES BOARD OF TAX APPEALS. Filed May 8, 1940.
(Caption—97500)

AMENDMENT TO ANSWER.

Filed May 8, 1940.

The Commissioner of Internal Revenue by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, pursuant to leave granted by the Board at the hearing of this case on May 6, 1940, to amend respondent's answer herein, for amendment to the respondent's answer herein alleges:

That the income of the trusts mentioned in the petition herein aggregating $22,560.02 for the calendar year 1934 and $16,800.00 for the period January 1, 1935, to August 3, 1935, included in the petitioner's gross income in the notice of deficiency involved herein under the provisions of Section 166 of the Revenue Act of 1934 is taxable also to the petitioner herein under Section 167 of the said Revenue Act for that the said income, in the discretion of persons not having a substantial adverse interest in the disposition of said income, may be held and accumulated for future distribution to the grantor; may be distributed to the grantor and may be applied to the payment of premiums upon policies of insurance on the life of the grantor.

Wherefore, respondent prays that the Board redetermine the deficiency herein to be the amount determined by the Commissioner, viz.: $24,642.60.

(Signed) J. P. Wenchel,
J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
F. R. Shearer,
Division Counsel.
D. A. Taylor,
Special Attorney, Bureau of Internal Revenue.

Filed May 6, 1940.

UNITED STATES BOARD OF TAX APPEALS.

(Caption—97500)

STIPULATION OF FACTS.

Filed May 6, 1940.

It is hereby stipulated by and between the parties to the above entitled cause through their counsel that the following statements of facts may be received in evidence as true, without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated.

1. The petitioner resides at 990 Sheridan Road, Hubbard Woods, Illinois. He filed income tax returns for 1934 and 1935, the years here involved, with the Collector of Internal Revenue for the First District of Illinois.

2. The notice of the deficiency here involved was mailed to the petitioner on December 29, 1938. A true and correct copy of the notice is attached to the petition heretofore filed in this proceeding. By reference said notice is hereby made a part of this stipulation to the same effect as if it were incorporated herein.

3. On March 31, 1930, the petitioner executed an agreement, a true copy of which is attached hereto as Exhibit 1, creating a trust for the benefit of his daughter, Joan Stuart Scudder.

4. On the same date the petitioner executed another agreement creating a trust for the benefit of his daughter,

Ellen. The provisions of this agreement are identical with the provisions of the agreement mentioned in paragraph 3 hereof except for the designation of Ellen as beneficiary instead of Joan. Ellen was married in 1930 shortly after the creation of this trust and her married name is Ellen Stuart Poole.

5. On the same date the petitioner executed another agreement creating a trust for the benefit of his son, John. The provisions of this agreement are identical with the provisions of the agreement mentioned in paragraph 3 hereof except for the designation of John as beneficiary instead of Joan.

6. The net income of the petitioner, as shown by his income tax returns and not including any income of the trusts, was $157,257.45 in 1934 and $185,534.77 in 1935.

7. The birth dates and ages (at nearest birthday) of said children are as follows:

29	Joan	May 31, 1904	36 years
	Ellen	June 21, 1907	33 years
	John	January 1, 1912	28 years

Throughout 1934 and 1935 Joan and Ellen were married.

8. On August 3, 1935, Ellen Shumway Stuart, wife of the petitioner, and Robert Douglas Stuart, brother of the petitioner, executed an amendment of the agreement mentioned in paragraph 3 hereof. A true copy of said amendment is attached hereto as Exhibit 2. On the same date said Ellen Shumway Stuart and Robert Douglas Stuart executed an amendment of the agreement mentioned in paragraph 4 hereof and an amendment of the agreement mentioned in paragraph 5 hereof, and said amendments contain the same provisions in regard to the respective agreements to which they refer as are contained in said Exhibit 2 in regard to the agreement to which it refers.

9. For the calendar years 1934 and 1935 the amounts of the net income of said trusts and the amounts thereof distributed to the beneficiaries of said trusts were as follows:

	1934	1935
Trust for Joan		
Net Income	$7,496.74	$8,295.00
Distributed to her	7,496.74	7,675.36
Undistributed	None	619.64
Trust for Ellen		
Net Income	7,496.74	8,295.00
Distributed to her	7,496.74	7,473.80
Undistributed	None	821.20
Trust for John		
Net Income	7,566.54	9,135.00
Distributed to him	1,863.33	2,740.50
Undistributed	5,703.21	6,394.50

10. The total net income of said trusts for 1934 was $22,560.02, and the respondent has determined that said net income is to be included in the gross income of the petitioner in computing his income tax for said year.

11. The total net income of said trusts for 1935 was $25,725.00 of which $16,800.00 was received by the trusts during the period from January 1, 1935, to August 3, 1935. The respondent has determined that said amount of $16,800.00 of the net income of the trusts is to be included in the gross income of the petitioner in computing his income tax for 1935.

Herbert Pope,
Attorney for Petitioner.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent.

31 EXHIBIT 1.

This Indenture, made this 31st day of March, 1930, between John Stuart, of Winnetka, Cook County, Illinois (hereinafter called the Donor), party of the first part, and Ellen Shumway Stuart, of Winnetka, Cook County, Illinois, Robert Douglas Stuart, of Lake Forest, Lake County, Illinois, and John Stuart, the Donor (hereinafter called the Trustees), parties of the second part, Witnesseth:

First. The Donor has assigned, transferred and set over, and does hereby assign, transfer and set over unto the Trustees seven hundred (700) shares of common capital stock of The Quaker Oats Company (sometimes referred to herein as the "Trust Fund"), and the Trustees are hereby authorized and empowered to receive and accept any and all property which at any time and from time to time may be delivered, transferred or assigned to the Trustees to become a part of the principal of the Trust Fund, which, together with any income therefrom accumulated as hereinafter provided, is to be held and disposed of together with the proceeds thereof as hereinafter in this Indenture provided.

Second. The Trustees shall have power and authority to receive and collect all income from the Trust Fund, including dividends, interest and any and all sums at any time payable in respect of any shares of stocks, bonds, or
32 other securities or property forming a part of the Trust Fund; to sell, transfer and assign any or all of the stocks, bonds, securities or property held by the Trustees under this instrument, and to invest and reinvest the proceeds thereof and the net income derived therefrom, which shall not be distributed as hereinafter provided, in municipal or government bonds, stocks, real estate mortgages, or other income-producing property or securities, real or personal, within or without the State of Illinois without being limited or restricted to investments as fixed by the statutes of the State of Illinois, and to make, execute and deliver all necessary and proper assignments, conveyances, deeds and other instruments; to exercise the voting power upon all shares of stock held by the Trustees hereunder, and to exercise every power, election and discretion,

give every notice, make every demand, and do every act and thing in respect of any shares of stocks and bonds which they could or might do if they were absolute owners thereof; to unite with owners of similar property in carrying out any plan for the reorganization of any corporation or company, the securities of which form a portion of the Trust Fund; to exchange the securities of any corporation for others issued by the same or by any other corporation upon such terms as the Trustees shall deem proper; to assent to the consolidation or merger of such corpora-
33 tion; to pay such assessments, expenses and sums of money as they may deem expedient for the protection of the interest of the Trust Fund in stocks, bonds, or other securities of any corporation or company; and to employ such agents and attorneys as may be necessary. Any person dealing with the Trustees shall not be required to see to the application of any money or moneys paid to the Trustees.

Third. For the purpose of this Indenture, net income shall include interest, dividends and rents from the stocks, bonds, and other securities and property constituting the Trust Fund after making any and all deductions therefrom in this Indenture provided for or required by law. Stock dividends, liquidating dividends and proceeds from the sale of any part of the Trust Fund, including profits, if any, shall constitute principal.

Fourth. For and during a period of fifteen (15) years from the date of this Indenture, the Trustees shall pay over and distribute, in reasonable installments, to Joan Stuart Scudder, of Winnetka, Cook County, Illinois, daughter of the Donor, so much of the net income from the Trust Fund as they in their sole discretion shall deem advisable, the undistributed portion of such income to be added to and become a part of the principal of the Trust Fund. From and after the expiration of fifteen (15) years from the date of this Indenture, the Trustees shall pay
34 to said Joan Stuart Scudder, in reasonable installments, the entire net income from the Trust Fund for and during her life.

Fifth: Upon the death of said Joan Stuart Scudder, the Trustees shall pay over the principal of the Trust Fund to her issue then surviving, if any, per stirpes, and if she shall leave no issue then surviving, to the issue then surviving of the Donor, per stirpes. If upon the death of said

Joan Stuart Scudder, any beneficiary hereunder shall be a minor, then the Trustees shall apply so much of the income from the share of each such beneficiary for his or her support, maintenance and education as to the Trustees shall seem advisable, and in such manner as to them shall seem best, and free from the control of any guardian, until he or she shall arrive at his or her majority, when the Trustees shall pay over to each such beneficiary the unexpended income and the principal of his or her share of the Trust Fund. In case of the death of any such beneficiary before he or she shall become entitled to receive the principal of his or her share of the Trust Fund, the Trustees shall immediately pay over his or her share thereof to the issue then surviving of said Joan Stuart Scudder, per stirpes, and if she shall leave no issue then surviving to the issue then surviving of the Donor, per stirpes.

Sixth. If at the time of the death of said Joan Stuart Scudder there shall be surviving no issue either of
35 said Joan Stuart Scudder or of the Donor, then the Trustees shall pay over the principal of the Trust Fund in equal shares to Princeton University and the University of Chicago.

Seventh. The interests by this Indenture created in either principal or interest shall not be grantable, transferable or otherwise assignable by anticipation, either by voluntary or involuntary act of the beneficiary, or by operation of law, and the said interests, or any part thereof, shall in no way or manner be liable for or be liable to be taken for any debt, liability or contract of the beneficiary whenever created, or be applied in any way or any manner to the payment thereof, it being the intention of the Donor to assure the payment of the income during the terms specified, and the distribution of the principal as specified to the beneficiary for her own individual use and benefit, and to limit her rights hereunder to such sums only as may become payable to her as herein provided.

Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to
36 withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and

delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.

Ninth. During the life of the Donor, the said Ellen Shumway Stuart and the said Robert Douglas Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect.

Tenth. The Trustees shall incur no liability or responsibility with respect to the validity of this Indenture, or any provisions thereof, or on account of any loss to or diminution in value of the property which may at any time constitute or be included in the Trust Fund, or on account of any other matter whatsoever, except such as may be due to their, his, her, or its actual fraud or willful mismanagement. The Trustees shall have a lien upon the income and principal of the Trust Fund for the reimbursement of any and all costs, expenses, and liabilities which they may incur or suffer by reason of this Indenture.

37 Eleventh. The Trustees, or any of them, may resign at any time by giving notice in writing of such resignation to the Donor during his life, and after his death by giving notice in writing of such resignation to the beneficiary or beneficiaries hereunder. In case of the resignation of one of the Trustees, or of his or her disability or incapacity to act further as Trustee, the remaining two Trustees shall have all the rights, powers, duties and authority granted to or imposed upon all of the Trustees under the provisions of this Indenture. In case of the resignation, disability or incapacity to act further of two or of three of the Trustees, then The Northern Trust Company, a corporation having its principal place of business in Chicago, Illinois, or its successor, shall act as joint Trustee or as sole Trustee, as the case may be, with all of the rights, powers, duties and authority by this Indenture granted to or imposed upon an original Trustee, in case it shall act jointly, or granted to or imposed upon all the original Trustees, in case it shall act alone.

Twelfth. Wherever the word "Trustees" occurs herein,

it shall be taken and held to embrace the Trustees or the Trustee for the time being under this Indenture, whether original or successor.

Thirteenth. In case The Northern Trust Company shall act as a Trustee hereunder, it shall be entitled to receive reasonable compensation for its services.

38 Fourteenth. The Trustees hereby accept the Trust created by this Indenture upon and subject to the terms and conditions thereof.

Fifteenth. It is understood that this Indenture is made in the State of Illinois and governed by the laws thereof.

In Witness Whereof, the Donor and the Trustees have hereunto set their hands and seals.

John Stuart (Seal)

Donor.

Ellen Shumway Stuart (Seal)
Robert Douglas Stuart (Seal)
John Stuart (Seal)

Trustees.

39 **EXHIBIT 2.**

Amendment of Indenture Made the 31st Day of March, 1930, Between John Stuart, of Winnetka, Cook County, Illinois (Therein Called the Donor), Party of the First Part, and Ellen Shumway Stuart, of Winnetka, Cook County, Illinois, Robert Douglas Stuart, of Lake Forest, Lake County, Illinois, and John Stuart, the Donor (Therein Called the Trustees), Parties of the Second Part, for the Benefit of Joan Stuart Scudder, Daughter of the Donor.

Whereas, in the Ninth paragraph of the Indenture made the 31st day of March, 1930, between John Stuart, of Winnetka, Cook County, Illinois (therein called the Donor), party of the first part, and Ellen Shumway Stuart, of Winnetka, Cook County, Illinois, Robert Douglas Stuart, of Lake Forest, Lake County, Illinois, and John Stuart, the Donor (therein called the Trustees), parties of the second part, for the benefit of Joan Stuart Scudder, daughter of the Donor, it was provided as follows:

"Ninth: During the life of the Donor, the said Ellen Shumway Stuart and the said Robert Douglas Stuart, or

the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect."

Now, Therefore, the undersigned, the said Ellen Shumway Stuart and the said Robert Douglas Stuart, being the persons mentioned in said paragraph "Ninth," hereby alter, change and amend said Indenture as follows:

First. Paragraph "Eighth" of said Indenture and all of the provisions of said paragraph are hereby cancelled and expunged so that said Indenture shall henceforth be of the same effect as if said paragraph and the provisions thereof were not included therein.

Second. All of the provisions of said paragraph "Ninth" of said Indenture are hereby cancelled and expunged so that said Indenture shall henceforth be of the same effect as if the provisions of said paragraph were not included therein, and said paragraph "Ninth" is hereby changed and amended so that as changed and amended it shall read as follows:

Ninth: This Indenture and all of the provisions thereof are irrevocable and not subject to alteration, change or amendment.

In Witness Whereof, the undersigned have hereunto placed their hands and seals this 3rd day of August, 1935.

Ellen Shumway Stuart (Seal)
Robert Douglas Stuart (Seal)

The undersigned, as Trustees of the Trust created by the Indenture above described, hereby acknowledge the delivery to them of the foregoing Amendment to said Indenture.

Ellen Shumway Stuart
Robert Douglas Stuart
John Stuart

41 UNITED STATES BOARD OF TAX APPEALS.

• • (Caption—97500) • •

STATEMENT OF EVIDENCE FROM REPORTER'S MINUTES.

Filed May 29, 1941.

Hearing at Chicago, Illinois, on the 6th day of May, 1940, at 2:00 o'clock, P. M.

The above-entitled proceeding came on for hearing on Monday, the 6th day of May, 1940, before the Honorable Marion J. Harron, Member of the United States Board of Tax Appeals, at Chicago, Illinois, pursuant to notice of hearing heretofore given; whereupon, the following proceedings were had and testimony heard, to-wit:

EVIDENCE ON BEHALF OF PETITIONER.

Thereupon, the petitioner, to maintain the material averments of his petition, introduced the following proof:

MR. JOHN STUART, the petitioner herein, called as
42 a witness on his own behalf, having been first duly sworn, was examined and testified as follows:

The Clerk: Please take the stand and state for the record your full name.

The Witness: John Stuart.

Direct Examination by Mr. Pope.

Q. Your name is spelled S-t-u-a-r-t?
A. Yes.
Q. What is your residence, Mr. Stuart?
A. Hubbard Woods, Illinois.
Q. And what is your occupation?
A. Milling business.
Q. What is the company that you are associated with?
A. Quaker Oats Company.
Q. What is your position with the Quaker Oats Company?

A. President.

Q. You are married and, under the stipulation, have three children?

A. Yes.

Q. They are still living?

A. Yes.

Q. In March, 1930, how old were the children at that time, approximately? The oldest one was Joan.

A. She was about 26.

43 Q. Was she married?

A. Yes.

Q. Ellen was the second child?

A. Yes.

Q. Was she married at that time?

A. No.

Q. Was she married shortly afterwards?

A. She was married in May of 1930.

Q. And the trust was made in March, March 31st?

A. I think so.

Q. The son, John Stuart, was how old?

A. About 18.

Q. Had you made provision for the children prior to the time that you created this trust in 1930?

A. You mean in the way of allowances?

Q. Well, allowances, or had you made any permanent provision prior to that time for them?

A. No.

Q. The provision made in these trusts was the first provision of that character that you had made for any of the children?

A. That's right.

Q. What was your reason for making a trust at that time?

Mr. Taylor: I object, your Honor. It seems to me that the reason for making the instrument is purely immaterial and irrelevant.

44 The Member: I will overrule the objection.

Mr. Taylor: May I have an exception?

The Member: Yes, you may.

You may answer.

A. My reason for creating the trusts at that time was due to the fact that Joan, the older girl, was married the previous fall. The younger girl was about to be married.

I had been giving each of the children an allowance.

I felt, and their mother agreed with me, that when they were married, as far as it was possible, we ought to make them independent to the extent that they could run their homes in a reasonable way.

Personally, I always have been, and was at that time, very much opposed to having the children, or the girls, on what I considered a remittance plan, which an allowance is.

Mr. Taylor: May I have an understanding that my objection to this line of testimony may be shown of record without repeating my objection?

The Member: Yes. I understand that your objection is that this testimony is not strictly material?

Mr. Taylor: It is not material or relevant.

The Member: That the trust instrument speaks for itself. I understand the objection is all the way through.

You may continue.

The Witness: It was for that reason that we created the trusts. The question of trustees—do you want me to go on and tell this?

45 The Member: No. I think you have answered that question that was asked.

By Mr. Pope:

Q. What was your idea with reference to the appointment of trustees under this trust, and the reason for providing that your wife and your brother, who were two of the trustees, should have discretionary powers with reference to modifying the trust?

Mr. Taylor: If your Honor please, we are getting close to an attempt to modify the provisions of the trust in that question. Of course, that is incompetent as well as being immaterial and irrelevant.

The Member: The objection to the testimony is that it goes to the explaining of the provisions of this trust and is immaterial. I am going to overrule that objection with the understanding, of course, that I shall have to weigh this testimony.

I think that some of it may be immaterial, but I don't want to interfere at this time with the plan of the counsel for the petitioner in presenting his case. The trust instrument speaks for itself. That, of course, is understood anyway.

Do you want the reporter to read the question?

Mr. Taylor: If your Honor please, may I be indulged just another moment? I gather from your Honor's remark

that it is a question of materiality, but it is not altogether a question of materiality. It is a question of competency, as well, insofar as the testimony undertakes to vary the terms of a trust instrument. In other words, if the
46 trust instrument is unambiguous on its face, and we must look to the face of the instrument alone in order to determine any ambiguity, any testimony which undertakes to explain or to extend or to take from the provisions of the trust is incompetent. That is a rule of evidence that is, I think, well established.

Mr. Pope: We are not attempting—I beg your pardon.

The Member: That clarifies your objection, Mr. Taylor, and if this testimony goes beyond a certain point and becomes entirely incompetent, I shall have to rule that it be stricken from the record, but I think we will have to wait and see how far the testimony goes.

I take it you want an exception?

Mr. Taylor: Yes, I want an exception to your ruling. I had understood his question to include some inquiry about the meaning of those provisions, and that is the reason I at that time made a part of my objection the matter of the competency.

Mr. Pope: My object is not to vary the instrument in any way, or to explain the terms, but simply to bring out facts with reference to the situation as it existed at that time, and in these cases, as your Honor knows, a great deal turns out on the reason for having members of the family trustees as compared with having a corporation as trustee.

In view of the provisions of the trust, I was merely asking the petitioner to explain the circumstances and reasons for having these particular persons as trustees.

47. The Member: Will the reporter read the question?

(Whereupon, the reported read the question as recorded as follows:

"Q. What was your idea with reference to the appointment of trustees under this trust, and the reason for providing that your wife and your brother, who were two of the trustees, should have discretionary powers with reference to modifying the trust?")

The Witness: All right?

The Member: Yes.

A. My reason for appointing my brother and my wife as trustees was that I knew they had the same point of view in regard to the children, their needs, and how they wanted

them to live, that I did. I knew they would be just as hard-boiled in dealing with them as I would.

I thought, on the basis of that belief, that their interests would be just as well protected and better served by having them instead of a corporate trustee. In addition to that, there was some saving, provided they functioned in that way.

The Member: You mean saving in—

The Witness: Cost.

The Member: In cost.

The Witness: In addition, I believed they would be just as hard-boiled with me as they would be with the children. They knew why the trusts were created. It was entirely done for the benefit of the children, and I felt sure they would resist any attempt by anyone to change that objective.

48 By Mr. Pope:

Q. Can you state what proportion, or what the relation of the amount of the principal that went into these three trusts in 1930 was as compared with your total net worth, approximately, at that time?

Mr. Taylor: I object to that, your Honor. It seems to me that testimony of what his net worth was and what the value of these securities was would be competent testimony by people competent to testify as to values, and so forth.

The Member: I think the petitioner is competent to testify to his own net worth. I will overrule the objection.

Mr. Taylor: The question was as compared with the value of the property going into these trusts.

The Member: I understand. The question is general. I overrule the objection.

Mr. Taylor: Exception, please.

The Member: The exception may be noted.

A. I don't think I can answer that question. I remember that it represented about a sixth of my income. That was the income from the trust as of that date, that is, the principal.

The Member: I don't think that answers the question.

By Mr. Pope:

Q. No, my question was whether or not, with reference to not the income, but the value of your property or estate as you estimated it at that time, how it compared with the principal that was in that trust.

49 Can you give a minimum figure as to your net worth at that time outside of the property in the trust?

A. Well, at the then values, something over 4 million.

Mr. Pope: That is all right.

The Member: What was the then value of the property you put in the trust?

The Witness: Let me see, now.

The Member: There are three trusts, are there?

Mr. Pope: Yes.

The Member: Can you tell that?

The Witness: 2,100 shares—

The Member: What is the principal amount of the three trusts?

Mr. Pope: 2,100 shares.

The Witness: And I think the market then was about $275. About 575,000.

Mr. Pope: All right. That is all.

Cross-Examination by Mr. Taylor.

Q. You are just trying to multiply the number of shares by your recollection that 275 was the value per share at that time?

A. Yes, sir.

Mr. Taylor: No cross-examination.

Witness excused.

Mr. Taylor: If your Honor please, at this time I would like to move to strike the testimony of this witness as being immaterial, irrelevant, and incompetent.

The Member: I overrule the objection, Mr. Taylor.

Mr. Taylor: Exception.

The Member: An exception will be noted.

Mr. Pope: That is all, if the Court please.

The Member: Has counsel for the respondent any witnesses?

Mr. Taylor: No, the respondent rests, if the petitioner has rested.

Mr. Pope: What shall we do about briefs?

The Member: The Clerk will read the dates.

The Clerk: Under the rules, the first briefs will be due June 20th for the original briefs, and July 5th for the reply briefs.

The Member: That concludes the hearing in Docket No. 97500, John Stuart.

Herbert Pope,
Attorney for Petitioner.

Agreed to:
(S) J. P. Wenchel.

19 UNITED STATES BOARD OF TAX APPEALS. Filed Nov. 29, 1940.

* * (Caption—97500) * *

Herbert Pope, Esq., Preston B. Kavanagh, Esq., and Benjamin M. Price, Esq., for the petitioner.

D. A. Taylor, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION.

HARRON: Respondent determined deficiencies of $14,054 and $10,588.60 in income tax for the years 1934 and 1935, respectively. The basic question is whether petitioner was taxable, in 1934 and in the first seven months of 1935, on the entire net income of three trusts which he created for the benefit of his three children. Other adjustments which respondent has made to the income reported by petitioner in his income tax returns for the years 1934 and 1935 are not contested.

Findings of Fact.

Petitioner is a resident of Hubbard Woods, Illinois, and filed his income tax return for each of the years 1934 and 1935 with the collector of internal revenue for the first district of Illinois.

20 Petitioner and his wife, Ellen Shumway Stuart, have three children: Joan, born May 31, 1904; Ellen, born June 21, 1907; and John, born January 1, 1912.

On March 31, 1930, petitioner executed three trust indentures by which he created three separate trusts, one for the benefit of each of his three children, and named himself, his wife, and his brother, Robert Douglas Stuart, as the trustees of each trust. To to the trustees of each trust petitioner transferred 700 shares of the common stock of the Quaker Oats Company, of which petitioner was president.

The provisions of each of the three trust indentures were substantially the same. For a period of fifteen years the trustees were to pay over to the child designated as the beneficiary of the particular trust "so much of the net

income from the Trust Fund as they in their sole discretion shall deem advisable" and to add the undistributed portion of the net income to the corpus of the trust. After fifteen years the trustees were to pay the entire net income from the trust to the beneficiary for life.

Upon the death of the beneficiary, the trustees were to pay over the principal of the trust to the beneficiary's issue then surviving or, if the beneficiary left no issue then surviving, to the issue then surviving of the petitioner; or, if there were surviving no issue of the beneficiary or of petitioner, to Princeton University and the University of Chicago in equal shares.

The trustees were empowered to collect all income; to sell any of the securities held in trust; to invest the proceeds from the sale of securities and the net income added to trust principal in "municipal or government bonds,
21 stocks, real estate mortgages, or other income-producing property or securities, real or personal, • • • without being limited or restricted to investments as fixed by the statutes of the State of Illinois"; to execute all necessary "assignments, conveyances, deeds and other instruments"; to exercise the voting power upon all shares of stock held in trust; and to exercise "every power, election and discretion, give every notice, make every demand, and do every act and thing in respect of any shares of stocks and bonds which they could or might do if they were absolute owners thereof"; to unite with others "in carrying out any plan for the reorganization of any corporation", the securities of which were held in trust; to exchange the securities of any corporation for others issued by any corporation; to assent to the consolidation or merger of any corporation; to pay "such assessments, expenses and sums of money as they may deem expedient for the protection of the interest" of the trust in the securities of any corporation; and to employ "such agents and attorneys as may be necessary."

Stock dividends, liquidating dividends and "proceeds from the sale of any part of the Trust Funds, including profits", were to constitute principal.

Each trust indenture contained a clause providing that the trustees were not to incur any liability "except such as may be due to • • • actual fraud or willful mismanagement", and a clause providing that any person dealing

with the trustees was not to be required "to see to the application of any money or monies paid to the Trustees."

22 Paragraphs Eighth and Ninth of each trust indenture provided as follows:

Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.

Ninth. During the life of the Donor, the said Ellen Shumway Stuart and the said Robert Douglas Stuart, or the survivor of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect.

On August 3, 1935, Ellen Sumway Stuart, petitioner's wife, and Robert Douglas Stuart, petitioner's brother, executed an amendment to each of the three trust indentures, canceling paragraph Eighth and changing paragraph Ninth to read as follows:

Ninth. This Indenture and all of the provisions thereof are irrevocable and not subject to alteration, change or amendment.

The net income of each of the three trusts in 1934 and 1935 was as follows:

Trust for	1934	1935
Joan	$ 7,496.74	$ 8,295.00
Ellen	7,496.74	8,295.00
John	7,566.54	9,135.00
Total	$22,560.02	$25,725.00

Of the total amount of the net income of the three trusts for 1935 $16,800 was received by the trustees during
23 the period from January 1, 1935, to August 3, 1935.

In 1934 and 1935 the net income of the three trusts was distributed to the beneficiaries thereof as follows:

Trust for	1934	1935
Joan	$7,496.74	$7,675.36
Ellen	7,496.74	7,473.80
John	1,363.35	2,740.50

In 1934 and 1935 Joan and Ellen were married.

Petitioner's net income (not including any income of the three trusts) was $167,257.45 in 1934 and $185,334.77 in 1935. At the time of the creation of the three trusts, petitioner's net worth was in excess of $4,000,000, and the property which he transferred to the trusts had a value of approximately $575,000.

Opinion.

The basic question is whether petitioner was taxable, in 1934 and in the first seven months of 1935, on the entire net income of the three trusts which he created for the benefit of his three children.

In computing the deficiencies in petitioner's income tax for 1934 and 1935, respondent included in petitioner's taxable income the entire net income of the three trusts during 1934 and during the period from January 1, 1935 to August 3, 1935, on which date the trust indentures were amended to provide that they were "irrevocable and not subject to alteration, change or amendment." In the deficiency notice respondent based his determination on section 166 (2) of the Revenue Act of 1934, the pertinent
24 provisions of which are set forth in the margin.[1] In an amended answer and in his brief respondent sup-

1. Sec. 166. Revocable Trusts.
Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

* * * * * *

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor.

ports his determinations under section 167 (a) of the Revenue Act of 1934, the pertinent provisions of which are set forth in the margin,[2] as well as under section 166 (2).

The basic question and the underlying facts in this proceeding are admittedly similar to those in the proceeding brought by petitioner's brother, R. Douglas Stuart, Docket No. 97501, which was heard immediately after this proceeding was heard. The provisions of the trust indentures involved in the two proceedings are substantially identical, and the arguments made by the parties under sections 166 (2) and 167 (a) are substantially the same in both proceedings.

Therefore, the decision in this proceeding is controlled by the decision in *R. Douglas Stuart*, 42 B. T. A. ....., promulgated this day. In the *R. Douglas Stuart* case the Board held that the taxpayer's wife and brother (the present petitioner) had the power to revest in the taxpayer title to the corpora of four trusts created by the taxpayer because they were given absolute powers to amend the trust indentures under paragraph Ninth thereof, the provisions of which were identical with the provisions of paragraph Ninth of the present trust indentures; that the taxpayer's wife and brother, who were not beneficiaries of the trusts, did not have substantial adverse interests in the disposition of the corpora of the trusts or the income therefrom; and that, therefore, the taxpayer was taxable under section 166 (2) of the Revenue Act of 1934 on the entire net income of the trusts during 1934 and during the period from January 1, 1935 to August 2, 1935, the date on which the trust indentures were amended to provide that they were "irrevocable and not subject to alteration, change or amendment."

On the grounds set forth in *R. Douglas Stuart*, *supra*, it

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2. Sec. 167. Income for Benefit of Grantor.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor * * *;

then such part of the income of the trust shall be included in computing the net income of the grantor.

is held that petitioner is taxable on the entire income of the three trusts, which he created for the benefit of his three children, during 1934 and during the period from January 1, 1935, to August 3, 1935, under section 166 (2) of the Revenue Act of 1934. *Mulham* v. *Commissioner*, 110 Fed. (2) 916. In view of this conclusion it is not necessary to consider the further contentions made by respondent to the effect that petitioner is also taxable on the entire net income of the trusts during the period in question under section 167 (a) of the Revenue Act of 1934.

Decision will be entered under Rule 50.

Entered Nov. 29, 1940.

Entered Jan. 10, 1941.

26 UNITED STATES BOARD OF TAX APPEALS.

* * (Caption—97500) * *

DECISION.

Pursuant to the determination of the Board, as set forth in its Memorandum Findings of Fact and Opinion entered November 29, 1940, and in accordance with the recomputation under Rule 50 of the petitioner's income tax liability filed by the respondent December 16, 1940, in which counsel for petitioner has acquiesced, it is

Ordered and Decided: That there are deficiencies in income tax as follows: for the year 1934 there is a deficiency of $14,054, and for the year 1935 there is a deficiency of $10,588.60.

(s) Marion J. Harron,
Member.

(Seal)

Entered January 10, 1941.

Filed Apr. 3, 1941.

51 UNITED STATES BOARD OF TAX APPEALS.

* * (Caption—97500) * *

PETITION FOR REVIEW AND STATEMENT OF POINTS.

Filed April 3, 1941.

The above named petitioner, by his attorneys, hereby filed this petition for a review of the decision of the United States Board of Tax Appeals entered on January 10, 1941,

in the above entitled cause, together with his statement of points.

1. The taxable years involved are the calendar years 1934 and 1935.

2. The petitioner filed his income tax return for each of said years with the Collector of Internal Revenue at Chicago, Illinois.

3. The petitioner seeks review of said decision of the United States Board of Tax Appeals by the United States Circuit Court of Appeals for the Seventh Circuit.

52 Statement of Points.

4. In seeking such review the petitioner files this his statement of points:

(1) The Board of Tax Appeals erred in holding that the income of the three trusts involved in this case was taxable to the petitioner under the provisions of section 166(2) of the Revenue Act of 1934.

(2) Under the evidence in this case the Board of Tax Appeals erred in concluding that power was vested in the petitioner's wife and brother, who were trustees of the trusts, to revest the principal of the trusts in the petitioner, who was the grantor and not a beneficiary of the trusts.

(3) The conclusion of the Board of Tax Appeals as to the unlimited power of the petitioner's wife and brother defeats the tax in this case. If the petitioner's wife and brother had the power, as the Board held, to revest the principal of the trusts in the petitioner, then the Board erred in failing to hold that the income of the trusts was not taxable to the petitioner under section 166(2) of the Revenue Act of 1934 because the petitioner's wife and brother had a substantial adverse interest to such revesting of principal in the petitioner in that they had an unlimited power to modify the trusts and accordingly could cause income or principal to be paid to themselves.

53 (4) The Board of Tax Appeals erred in holding that there is a deficiency in income tax owing by the petitioner for the year 1934 in the amount of $14,054 and for the year 1935 in the amount of $10,588.60.

(5) The decision of the Board of Tax Appeals is not supported by any substantial evidence and is contrary to the evidence.

Wherefore, the petitioner prays that the said decision of the United States Board of Tax Appeals be reviewed and

reversed and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected.

Herbert Pope,
Herbert Pope,
Benjamin M. Price,
Benjamin M. Price,
Preston B. Kavanagh,
Preston B. Kavanagh,
Attorneys for Petitioner,
120 South Salle Street,
Chicago, Illinois.

Filed Apr. 5, 1941.

54 IN THE UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

John Stuart, *Petitioner on Review,* vs. Commissioner of Internal Revenue, *Respondent on Review.*	B. T. A. Docket No. 97500.

NOTICE OF FILING PETITION FOR REVIEW AND STATEMENT OF POINTS.

Filed April 5, 1941.

To: J. P. Wenchel, Chief Counsel,
Bureau of Internal Revenue.

You are hereby notified that John Stuart did, on the 3rd day of April, 1941, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit, of the decision of the Board heretofore rendered in the above entitled case. Copies of the petition for review and the statement of points as filed are hereto attached and served upon you.

Daied this 3rd day of April, 1941.

(S) B. D. Gamble,
B. D. Gamble,
Clerk, U. S. Board of Tax Appeals.

Service of copy of Petition for Review and Statement of Points acknowledged this 5th day of April, 1941.

J. P. Wenchel,
C. A. R.

55 UNITED STATES BOARD OF TAX APPEALS. Filed May 29, 1941.

John Stuart, *Petitioner,*
vs.
Commissioner of Internal Revenue, *Respondent.*
} Docket No. 97500.

PRAECIPE FOR RECORD.

Filed May 29, 1941.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit copies duly certified as correct of the following documents and records in the above entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Seventh Circuit heretofore filed by the petitioner:

1. Docket entries of the proceedings before the Board in this case.
2. Pleadings before the Board in this case:
(a) Petition.
(b) Answer to petition.
(c) Amendment to answer.
3. Memorandum findings of fact and opinion of the Board, promulgated November 29, 1940.

56 4. Decision of the Board entered January 10, 1941.

5. Petition for review and statement of points, with proof of service.

6. Stipulation of facts, including exhibits, filed May 6, 1940.

7. The agreed statement of evidence, being portion of official report of hearing in this case on May 6, 1940, commencing on page 14 thereof with "Evidence on Behalf of Petitioner" and continuing to end of report on page 23.

8. This praecipe.

Herbert Pope,
Attorney for Petitioner.

Agreed to:
(S) J. P. Wenchel.

57 UNITED STATES BOARD OF TAX APPEALS.
• • (Caption—97500) • •

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 56, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 5th day of June, 1941.

B. D. Gamble,
(Seal) *Clerk, United States Board of Tax Appeals.*

Entered May 6, 1941. 58 UNITED STATES BOARD OF TAX APPEALS.
• • (Caption—97500) • •

ORDER ENLARGING TIME.

On motion of counsel for petitioner and consent of counsel for the respondent, it is

Ordered that the time for preparation of the evidence and for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit be and it is hereby extended to June 12, 1941.

(Signed) C. R. Arundell,
Member.

Dated: Washington, D. C.
May 6, 1941.

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Now, June 5, 1941, the foregoing is certified from the record as a true copy.

B. D. Gamble,
B. D. Gamble,
(Seal). *Clerk, U. S. Board of Tax Appeals.*

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing printed pages contain a true copy of the printed record, printed under my supervision and filed on the eleventh day of July, 1941, in the following cause: Cause No. 7695, John Stuart v. Commissioner of Internal Revenue, respondent, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof, I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this thirteenth day of February A. D. 1942.

[SEAL]

KENNETH J. CARRICK,
Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit held in the City of Chicago and begun on the first day of October in the year of our Lord one thousand nine hundred and forty, and of our Independence the one hundred and sixty-fifth.

7695

JOHN STUART, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals

And, to-wit: On the nineteenth day of December, 1941, there was filed in the office of the Clerk of this Court, the opinion of the Court, which said opinion is in the words and figures following, to-wit:

In the United States Circuit Court of Appeals for the Seventh Circuit

October Term and Session, 1941

No. 7695

JOHN STUART, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

No. 7696

R. DOUGLAS STUART, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petitions for Review of Decisions of the United States Board of Tax Appeals

December 19, 1941

Before SPARKS, MAJOR and MINTON, Circuit Judges.

SPARKS, Circuit Judge. These petitions seek to review decisions of the United States Board of Tax Appeals. We shall treat them in the order of their numbers.

In the case of John Stuart, the Commissioner determined income tax deficiencies against him for the years 1934 and 1935. The Board confirmed that ruling and held that under Section 166 (2) of the Revenue Act of 1934, petitioner was taxable on the net income of three trusts which he had created in 1930 for the benefit of his three children.

The evidence comprised a stipulation of facts and petitioner's testimony, which substantially is as follows:

On March 31, 1930, petitioner executed three trust agreements, one for his daughter Joan, who had just been married; one for another daughter, Ellen, who was about to be and is now married; and one for his son, John. In 1934 all three children were over twenty-one years of age.

Petitioner created the trusts because he felt that the daughters ought to be made independent so that they could conduct their homes in a reasonable manner. He had been giving his children allowances, a plan which he did not approve, particularly after marriage. He appointed his wife, Ellen Shumway Stuart, his brother Robert Douglas Stuart, and himself as trustees of each

trust. His reason for appointing his wife and brother was that he knew that they shared his point of view in regard to the children, their needs, and how he wanted them to live, and that they would be just as strict in dealing with the children as he would be. He thought the children's interests would be better served and protected by having them as trustees than by having a corporate trustee. They knew that the trusts were created entirely for the benefit of the children, and the petitioner felt sure that as trustees they would resist any attempt by anyone to change that objective.

Petitioner's net worth, at the time the trusts were created, exceeded $4,000,000 exclusive of the trust property which was worth about $575,000. Each trust made the same provision for each child and each comprised 700 shares of common stock of the Quaker Oats Company, of which petitioner was president.

For the first fifteen years the trustees were to pay to the child designated as the beneficiary of the particular trust so much of the net income as in the discretion of the trustees they should deem advisable, and they were directed to add any undistributed income to the principal of the trust. After fifteen years the trustees were to pay the entire net income to such child. Upon the death of a child the trustees were to pay the principal of the trust to that child's issue then living, or, if there were no such issue, then to the issue of the petitioner then living, or, if there were no such issue then living, then in equal shares to Princeton University and the University of Chicago. The trustees were given the usual broad powers of management and administration. There was a spendthrift clause, a clause exonerating the trustees from liability except for fraud or willful mismanagement, a provision appointing a trust company as a co-trustee if two of the trustees should resign, and a provision that the trust should be governed by the laws of the State of Illinois.

The eighth and ninth articles of each indenture provided as follows:

"Eighth. The Donor reserves and shall have the right at any time and from time to time to direct the Trustees to sell the whole of the Trust Fund, or any part thereof, and to reinvest the proceeds in such other property as the Donor shall direct. The Donor further reserves and shall have the right at any time and from time to time to withdraw and take over to himself the whole or any part of the Trust Fund upon first transferring and delivering to the Trustees other property satisfactory to them of a market value at least equal to that of the property so withdrawn.

"Ninth. During the life of the Donor, the said Ellen Shumway Stuart and the said Robert Douglas Stuart, or the survivor

of them, shall have full power and authority, by an instrument in writing signed and delivered by them or by the survivor of them to the Trustees, to alter, change or amend this Indenture at any time and from time to time by changing the beneficiary hereunder, or by changing the time when the Trust Fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect."

On August 3, 1935, taxpayer's wife and brother above named, executed an amendment to each of the three trust indentures cancelling the eighth article and changing the ninth to read as follows:

"Ninth. This Indenture and all of the provisions thereof are irrevocable and not subject to alteration, change or amendment."

The total net income of the three trusts for 1934 was $22,560.02. Of this, Joan and Ellen each received the full shares of $7,496.74. There was distributed to John for that year $1,863.33, and there remained in his trust an undistributed amount of $5,703.21. For 1935 there was a total net income of the trusts of $25,725. Of this, the trusts of Joan and Ellen were each entitled to $8,295, and John's trust was entitled to $9,135. There was a partial distribution which left undistributed balances of income for this year due the trusts in the order named, the respective sums of $619.64; $821.20; and $6,394.50.

The Commissioner determined that the net income from each of the three trusts for 1934, and from January 1, 1935, to August 3, 1935, the date of the amendment, was taxable to the taxpayer, and upon that basis determined the deficiency. The Board sustained the Commissioner.

The Commissioner, in support of the Board's ruling, relies upon Section 166 of the Revenue Act of 1934, the material part of which reads as follows:

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested

* * * * *

"(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

"then the income of such part of the trust shall be included in computing the net income of the grantor."

Under this section the Commissioner contends that the terms of each indenture require the conclusion that there were no fiduciary restrictions upon the power of the taxpayer's wife and brother to revest the corpus of each trust in the taxpayer. Furthermore, he contends that the taxpayer's wife and brother had no interests in the property which were substantially adverse to

those of the taxpayer, and this he asserts to be true in view of family and business relationships, and the existence of an identical power in the taxpayer and his brother's wife with respect to trusts executed by his brother for the benefit of his own children.

The Commissioner bases his argument upon the premise that "if there is any possibility that the grantor (John Stuart) might become revested with the corpus of the trust the income is taxable to him." He asserts that this premise is contained in Treasury Regulations 86 under section 167 ("which provides for the taxation of the income of a trust to the grantor if he has retained an interest in the income thereof"), and that this regulation should be applied to section 166 which complements section 167. He further states that the test contained in his premise has been unanimously applied to section 167 by all the Circuit Courts of Appeal to which the question has been presented, including this court. See Graff v. Commissioner, 117 F. 2d 247. All the cases cited support the treasury regulation. However, none of them support the Commissioner's premise, because it is not supported either by the regulation or the Statute. The key thought of the Commissioner's premise is merely the *possibility* of *reinvestiture*. The "single test" of the regulation for section 166, is "whether the grantor has failed to *divest himself* * * * of every right which might by any possibility enable *him* once more to possess and *enjoy in title* the trust corpus." [Our emphasis.] It is only in case the grantor has retained any such interest that he is taxable with respect to the income of the trust. His reinvestiture must be based on some right which he has retained *ab initio*.

In the instrument before us, the grantor neither reserved nor retained any right which might by any possibility *enable him* to repossess or enjoy in title the trust property. True, in article eight he reserved the right at any time and from time to time to withdraw and take over to himself the whole or any part of the trust fund, but before doing so he must transfer and deliver to the trustees other property satisfactory to them, of a market value at least equal to that of the property so withdrawn. It is not denied that this provision was inserted to preserve to the trust the benefit of the grantor's vast knowledge and experience, and yet any such shifting or trading of investments must first be approved by the other trustees, and in no other respect was their power to invest or reinvest disturbed. This of course was a retention of a right, although not an exclusive one, yet it was not such a right as could by any possibility enable the grantor to possess and enjoy in title the trust corpus. It was merely the

right to make an offer to exchange securities which could not be enforced by the grantor without the consent of the other trustees.

The Commissioner contends, however, that John Stuart's right to recapture the corpora of these trusts is found in the exercise of the other trustees' discretion, as set forth in the original ninth article. He does not contend that this is either a legal, an equitable, or a moral right which the grantor could enforce, but he insists that because of the cross relationship between the grantor and his brother, R. Douglas Stuart, a trustee, the latter would be amenable to the wishes of the grantor. This cross relationship, aside from consanguinity and business relations, also contemplates the fact that almost two years subsequent to the declaration of the John Stuart trusts, his brother R. Douglas Stuart, declared a trust primarily for the benefit of his children in which he had named himself and his wife and petitioner as the trustees with substantially the same powers as those given to the trustees in the John Stuart trusts. Likewise the Commissioner insists that because of the marital relation between petitioner and his wife, she would be amenable to his wishes even to the point of depriving her own children of their rightful and perhaps needed allowance. Assuming without admitting such effect of these cross relationships as a legal conclusion, we submit that under such circumstances the recapture of the corpora of the trusts by petitioner would be by virtue of the future exercise of his influence over the other trustees and not by virtue of any right which he reserved or failed to grant at the time of his declaration, which is the "single test" promulgated by the Treasury Regulation.

We are not dealing here with technical considerations, niceties of the law, or the legal paraphernalia which inventive genius has constructed as a refuge from surtaxes. There is no inventive genius here; it is all quite old in the art. Congress, long ago and quite clearly, described the issue, and the Treasury Department, in unambiguous language, promulgated a regulation which laid down just one test for us to follow in determining the taxpayer's liability, if any.

The basic question then is whether the grantor by his original declaration "failed to divest himself * * * of every right which might by any possibility enable him once more to possess and enjoy in title the trust corpus." If he failed to do so he can not prevail here. If he did not thus fail he should prevail, even though as a result, his surtaxes may have been minimized. We fully appreciate that nothing should obscure this basic issue, and we feel assured that the mere decrease in the amount of the grantor's surtaxes is not sufficient to authorize us to alter the

plain words of the Statute and the Treasury Regulations under the guise of judicial construction. To lawfully reduce one's surtaxes, by gift or otherwise, is permissible, and of itself raises no presumption of an intention to defraud the Government. We think the grantor has fully met the test of the regulation, unless the trustees, other than the grantor, have the power under the declaration to revest the grantor with the income or corpus, and have no power to invest any other person with such property who after such investiture must be considered as holding a substantially adverse interest to that of the grantor.

The Board held that the instrument gave to the grantor's wife and his brother, or the survivor of them, during the grantor's life; full power and authority to alter the instrument by changing the beneficiary, or by changing the time when the trust fund, or any part thereof, or the income, is to be distributed, or by changing the Trustees, or in any other respect. Hence it held that power to revest in the grantor was vested in the wife and brother, who were persons not having a substantial adverse interest in the corpus. If the wife and brother had the power under this provision to substitute the grantor as sole or part beneficiary, they likewise would have the same power to substitute themselves, or any one else, as beneficiaries. In either event it is not necessary that such event should have transpired. If the wife and brother had the power to name themselves, or others than the grantor, as beneficiaries, that power or right was certainly adverse to the grantor's interests. It was full and complete and not limited by reservation or failure of divestiture. Indeed, if the grantor by his instrument had in any manner reserved any interest in the property in question the other trustees would be powerless to pass a complete title. None of the cases cited by the Commissioner presented facts similar to those here. In each there was a clear reservation in the grantor, or a power or discretion in the trustees by means of which the grantor could be revested, and there was no power given any trustee, not a grantor, to substitute beneficiaries. See Kaplan v. Commissioner, 66 F. 2d 401; Rollins v. Helvering, 92 F. 2d 320; Altmaier v. Commissioner, 116 F. 2d 162; White v. Higgins, 116 F. 2d 312; Graff v. Commissioner, 117 F. 2d 247; Commissioner v. Caspersen, 119 F. 2d 94 (certiorari denied October 13, 1941); Kent v. Rothensies, 120 F. 2d 476 (certiorari denied October 13, 1941); Whiteley v. Commissioner, 120 F. 2d 782 (certiorari denied October 13, 1931).

However, we are not convinced that the wife and brother of the grantor were empowered by this instrument to revest title to this property in the grantor, their co-trustee. A court of equity has power to control the administration of a trust so that

it will accord with the purposes of the grantor. A discretion lodged in a trustee is rarely, if ever, to be regarded as a permit to act arbitrarily. Such discretion should be confined to the exercise of judgment not unreasonable in the light of the purposes of the trust and of the circumstances in which it is sought to be exercised. The power of the court exists solely for the protection of the right of the grantor and the beneficiaries (see Rollins v. Helvering, supra), and the laws of Illinois in this respect are applicable to this case. It was conceded in argument by the Commissioner that under the Illinois law the wife and brother as trustees would have no right to substitute themselves, or either of them, as beneficiaries, yet he insists that they would have the right to substitute their co-trustee, the grantor, as the sole beneficiary. If this be true then the grantor reserved nothing in the original grant, and there would be no tax due from him under the statute. See Huffman v. Commissioner, 39 B. T. A. 880.

However, we are convinced that the wife and brother as trustees had no authority under the Illinois law to revest the property in the grantor. This would be to give them power, not only to destroy the trust but to dissipate the proceeds contrary to the purposes set forth in the declaration, and it would also furnish an opportunity by secret agreement for subsequent distribution among the trustees. Such a door should not be left open. Congress and the courts, theoretically at least, have always regarded the preservation of trust funds as a sacred obligation, and they have always and everywhere proceeded on the theory that a trust officer should not be permitted to be placed in any position where he may be "tempted above that which he is able."

Both by law and the express request of the declaration, the meaning and effect of the trust is to be determined by the laws of Illinois. See Freuler v. Helvering, 291 U. S. 35; Blair v. Commissioner, 300 U. S. 5; Morgan v. Commissioner, 309 U. S. 78. Federal authorities control only those cases where the apparent transfer of a right to income is not real, or is only temporary. See Harrison v. Schaffner, 312 U. S. 579. Where great discretion is vested in a trustee, its exercise is subject to the control of a court of chancery. Maguire v. City of Macomb, 293 Ill. 441. A very broad discretion conferred upon a trustee in the selection of beneficiaries does not constitute an unlimited discretion which the court can not control. Welch v. Caldwell, 226 Ill. 488. In Jones v. Jones, 124 Ill. 254, the court said: "It is true that the daughters are invested with a large discretion as to the manner in which they shall execute the trust * * *; but the devise being to them for the use and benefit of the children of the deceased son, the discretion vested in them will not

defeat the trust. * * * The daughters, as trustees of this share, are not invested with discretion to withhold the trust fund absolutely from the cestuis que trust. The fund is not theirs, in equity, and they can not make it so by a refusal or neglect to exercise the discretion vested in them. Their discretion as trustees of this fund is subject to the control of the courts of equity, and can not be arbitrarily exercised so as to deprive the beneficiaries of all benefit of the fund." See also Frank v. Frank, 305 Ill. 181. The same principle seems to prevail in all jurisdictions both state and federal. See Restatement of Law of Trusts, Sec. 170; Scott on Trusts, Vol. 2, Sec. 187; Lovett v. Farnham, 169 Mass. 1, 47 N. E. 246; Fleischman v. Commissioner, 40 B. T. A. 672 (acquiesced in by Commissioner); Downs v. Commissioner, 36 B. T. A. 1129.

In the last-named case the Board said that "in the construction of a trust instrument the intention of the grantor is of utmost importance." This is true, and it constitutes the pole star which should guide courts in determining the purpose of the trust and the limitation of the trustee's discretion. We are convinced that under the terms of these trusts no contingency could arise which would enable the grantor to have the income or corpus distributed to him, actually or constructively, and it is well to note that the instrument itself provides for liability of the trustees in case of fraud or mismanagement.

The Commissioner urges that the Board's ruling must be sustained under Helvering v. Clifford, 309 U. S. 331. He seems to construe that decision as meaning that the interests of beneficiaries under a trust may be disregarded for purposes of taxing the grantor if the beneficiaries are members of his family, because they would probably not assert their rights. It can not well be denied in such event that a question presents itself for a court of chancery to determine, which federal courts will not ignore. We think the ruling in the Clifford case did not go so far as to hold that mere family solidarity gave the federal courts the right to ignore the State jurisdiction to determine the rights of beneficiaries under a trust, and the extent of the trustees' discretion. The elements required to bring a taxpayer within the scope of that case are quite clearly noticed in Helvering v. Elias, 122 F. 2d 171. They are (a) close family relationship, (b) short trust term, and (c) reservation of powers of management. See also Commissioner v. Barbour, 122 F. 2d 165. Certiorari was denied in both of these cases. In the present case we have no short terms, nor power of management in the grantor.

We think the Board erred in holding that the petitioner John Stuart was liable under Section 166 (2) of the Act, and from what we have said we are of the opinion that he was not liable

under Section 167 (a), which deals with revocable trusts, or under Section 22, which deals with gross income.

With respect to cause number 7696, the petitioner, R. Douglas Stuart, on March 25, 1942, created four separate trusts for the benefit of his four children, Robert, Anne, Margaret and Harriet. They were all minors and their birth dates respectively were [illegible] 25, 1916, January 11, 1920, January 3, 1922, and February [illegible].

The provisions of these trust agreements were substantially the same except for one provision hereafter noted. Each of the trusts comprised 1500 shares of common stock of the Quaker Oats Company, of which the petitioner was first vice-president. The trustees were the petitioner, his wife, Harriet McClure Stuart, and his brother, John Stuart.

The trust agreements provided that the trustees should pay to the child designated as the beneficiary of the particular trust agreement or apply to such child's education, support and maintenance, so much of the net income as the trustees should deem advisable, and that the trustees should add the unexpended portion of the net income to the principal of the particular trust. When the beneficiary became 30 years of age (25 years of age in the case of Robert) the trustees were to pay over to such beneficiary one-half of the principal of the trust. Thereafter the trustees were to pay over to the beneficiary the net income from the remaining one-half of the principal of the trust until such beneficiary became 35 years of age (30 years of age in the case of Robert) when the trustees were to pay over to the beneficiary the remaining one-half of the principal of the trust.

In the event of the death of a child of the petitioner before receiving all of the principal of his trust, the trustees were to pay over the principal of the trust to the child's issue then living, or, if there were no such issue, then to the living issue of the petitioner, or, if there were no such issue then living, then in equal shares to Princeton University and the Presbyterian Hospital of Chicago. The trustees were given the usual broad powers of management and administration. There was a spendthrift clause, a clause exonerating the trustees from liability except for fraud and willful mismanagement, a provision appointing a trust company as a co-trustee or sole trustee if two of the trustees should resign, and a provision that the trust should be governed by the laws of the State of Illinois.

Paragraphs eight and nine of these trusts are identical with paragraphs eight and nine of the John Stuart trust, except as to the names of the donor and the other two trustees.

On August 2, 1935, each of these trust agreements was amended by the two trustees, Harriet McClure Stuart and John Stuart,

by eliminating paragraph eight, and changing paragraph nine so as to make the indenture and all of its provisions irrevocable and not subject to alteration, change or amendment.

In all the years from the creation of the trusts to and including 1935, the entire net income of these trusts was accumulated and added to the principal, except that in 1934 there was distributed to Robert $1,391.50, and in 1935 there was distributed to him $1,882.50 of the income. At the time of the creation of the four trusts, the taxpayer's net worth was approximately $3,000,000, and the property which he transferred to the trusts had a value of approximately $600,000.

Bearing on the question of motive, the petitioner had discussed the matter with his brother, John Stuart, prior to the creation of the trusts by his brother, John, in 1930, and it seemed to this petitioner that John's was a wise procedure. When the trusts were created, petitioner's children were all minors. He said: "Times were very uncertain and I felt that while I had an opportunity to provide for them in the form of a trust, that was the wise thing to do." No changes have been made in the beneficiaries of the trusts nor in the property that went into them.

The Commissioner determined that the entire net income of the trusts for 1934, and from January 1 to August 2, 1935, was taxable to the petitioner under section 166 (2) of the Act, and the Board affirmed that determination. The Board did not deem it necessary to consider the applicability of sections 167 (a) and 22 (a) of the Act.

The same questions are presented in this case as were presented in the former case. The only factual difference with respect to the trusts of the two brothers is that during the years 1934 and 1935 John's children were all of age, and the children of Douglas were all minors. It is to be noted with respect to the trusts of the daughters of Douglas, that the entire income involved was accumulated and added to the principal for later distribution to them at the specified ages, whereas with respect to John's daughters substantially all the income was distributed currently to them. With respect to their sons, it is further to be noted that relatively small sums were paid to them, and the balance was accumulated and added to the principal.

What we have said in the case of the trusts for John's children, with respect to the applicability of sections 166 (2) and 167 (a) (2), need not be repeated. We hold that those two sections are not here applicable.

The remaining question is whether section 22 (a) is applicable, because of the minority of his children, under Douglas v. Willcuts, 296 U. S. 1. We think it is, to a limited extent, because in each trust here involved the indenture provides for the use of

the income for the education, support and maintenance of the minor children; and if it was so used, such applications, under the Willcuts case, must be considered as having been used for the grantor's benefit in the discharge of his obligation to his minor children. Such obligation is, of course, limited to a reasonable allowance consistent with the taxpayer's station in life, and the minor's welfare. Under the ruling of Commissioner v. Grosvenor, 85 F. 2d 2, the burden was on the grantor, if he were to escape taxation on the trust income, to prove that the distributed income was not in fact used for those purposes. We think that burden has been met with respect to all of the income of these trusts, with the exception of $1,391.50 which was paid to Robert in 1934, and $1,882.50 which was paid to him in 1935. All of the income received, aside from these two sums, was admitted to have been credited to principal, and this fact would seem to eliminate any possibility that it was or could ever be applied to the support or education of the minor children.

The Commissioner relies on Whiteley v. Commissioner, 120 F. 2d 782 (certiorari denied October 13, 1941), as holding that the income from the trusts must be taxed against the income of the taxpayer because it was available and could have been used to discharge his obligations to his minor children, although in fact it never was. We are not convinced that the Whiteley case goes that far, although the precise language referred to is found in that opinion if it be read separately from its context. In that case, and other seemingly analogous cases, there were clear reservations of rights to the grantor which might well be considered as bringing the trusts within the provisions of section 167 as well as section 22 (a). Indeed, the opinion in the Whitely case informs us, with respect to the childrens' trusts, that the respondent there relied upon sections 167 (a), (1) (2) (3) (b), and the court quotes them as the "applicable statute," and adds that "an examination of a line of Supreme Court decisions under section 22 (a), the gross income section of the statute, seems to leave little or no room to doubt the correctness of the Board's conclusion * * *" It should be further noted that that court also found that the settlor could have received the entire income and applied it to the support of his minor children, which he did not choose to do, and it further found that the settlor controlled the use of the money, neither of which rights did the settlor reserve in either of these trusts. The burden being on this taxpayer to prove that the distributed income was not in fact used for the education and support of his minor son, we think that the amount of such income which was actually received by him, or for him, must be considered as being income of the grantor, because there is no evidence to the contrary.

In cause number 7695 the decision of the Board is reversed. In cause number 7696 the Board's decision is affirmed as to the income which was distributed to Robert Stuart during the years 1934 and 1935. The decision is reversed as to those amounts of income which were not distributed to the beneficiaries but were credited to the corpora during the years in question. The causes are ordered remanded for further proceedings not inconsistent with this opinion.

A true Copy:
Teste:

Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

And, on the same day, to-wit: On the nineteenth day of December, 1941, the following further proceedings were had and entered of record, to-wit:

FRIDAY, *December 19, 1941.*

Court met pursuant to adjournment.

Before: Hon. William M. Sparks, Circuit Judge; Hon. J. Earl Major, Circuit Judge; Hon. Sherman Minton, Circuit Judge.

7695

JOHN STUART, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the United States Board of Tax Appeals entered in this cause on January 10, 1941, be, and the same is hereby, reversed, and that this cause be, and it is hereby, remanded to the said United States Board of Tax Appeals for furthef proceedings not inconsistent with the opinion of this Court filed herein this day.

United States Circuit Court of Appeals For the Seventh Circuit

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that

the foregoing typewritten and printed pages contain a true copy of the opinion filed on the nineteenth day of December, 1941, and the judgment entered on the nineteenth day of December, 1941, in the following entitled cause:

Cause No. 7695

JOHN STUART, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this thirteenth day of February A. D. 1942.

[SEAL]

KENNETH J. CARRICK,
Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

U. S. GOVERNMENT PRINTING OFFICE, 1942

SUPREME COURT OF THE UNITED STATES

Order allowing certiorari

Filed April 27, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

468654—42 U. S. GOVERNMENT PRINTING OFFICE: 1942